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A bad week for tax planning

Andrew Howard comments on two recent First-tier Tribunal decisions and their potential implications for UK taxpayers.

During the second week of August two decisions of the First-tier Tribunal were released[1], which illustrate the difficulties that taxpayers are likely to face in the Tribunal if HMRC takes issue with their tax planning. Interestingly on both occasions, Jonathan Peacock QC represented the taxpayer, and Judge Rachel Short was part of the tribunal.

Lloyds Bank Leasing (No 1) Limited v HMRC Commissioners

In the *Lloyds Leasing* case, the tribunal revisited the difficult question, remitted to it by the Court of Appeal, of whether one of the main objects of the structured leasing transactions entered into by the appellant was to claim writing down allowances.

Given that the Court of Appeal had effectively already rejected the proposition that the appellant could not be saved from this provision by the overwhelming commercial purpose of the transaction taken as a whole, it was no surprise that the taxpayer lost, but I was struck by some of the comments of the Tribunal in reaching this conclusion, in particular:

> *"In the paradigm case s.123(1)*[2] *is intended to apply to a ship purchased outright by an established UK shipping company and leased to an overseas customer… the purpose of sub-s (4)… is to exclude from the benefit of the allowance those transactions which do not fall within the paradigm … Indeed sub-s(4), as we read it, is aimed precisely at the person who has an eye to the tax advantage which might be gained."*

This chimes with the explanation of the concept of 'tax arrangements' in the general anti-avoidance rule (GAAR) guidance[3], which also applies a main purpose test:

> *"…what this test is seeking to establish is whether a transaction which would otherwise have occurred has been reshaped, or has been entered into under different terms and conditions, in order to change significantly the tax result that would otherwise have arisen, and where the desired tax result is itself a substantial objective. The reshaping or difference in terms and conditions may be obvious and contrived; but this would not necessarily be the case and quite subtle changes may be involved (for example, in an appropriate context, simply changing the accounting date of a company in order to take advantage of transitional rules introducing new provisions)."*

Where a main purpose test is in point, on this view it seems that any tax planning – that is any step to shape a transaction in light of the applicable tax legislation – runs the risk of a finding of a tax main purpose.

Does this mean that tax advisers are left impotent (at least in the many areas of the tax code covered by main purpose tests), able to point out tax disadvantages, but unable to influence the transaction structure to avoid them, because to do so would trigger the main purpose test and so be self-defeating?

That would clearly be an overreaction. For one thing, many more complex transactions do not even have a structure as such until tax advisers (in conjunction with others) provide one. I don't think anyone would say, just because a transaction has been implemented on the basis of a structure paper prepared by tax advisers, that it automatically falls foul of any applicable main purpose test. To be fair, both the judgment and the GAAR guidance refute the proposition that a transaction will have a tax main purpose simply because tax advisers are engaged.

In addition, there are significant differences between the main purpose test at issue in this case and the main purpose tests which are more commonly encountered in the tax legislation. To my mind, the major difference is that the test at issue here asked whether the relevant main purpose was to 'obtain allowances', rather than the more typical 'obtain a tax advantage'.

This is relevant because the 'tax advantage' element brings in the need to test whether an advantage arises against a comparator transaction, the long-established *Parker*[4] test. Under this test, HMRC needs to posit the alternative transaction (which may be no transaction at all) which the taxpayer would have entered into in order to achieve the same commercial objective but without the same tax benefit. It is well established that this does not mean the least efficient similar transaction that the taxpayer could have entered into. If this limb had been present, I think it would have been more difficult for the tribunal to have made quite such a sweeping statement on the purpose of s.123(4).

It is also noteworthy that the judgment appears to go further than HMRC was actually arguing. Counsel for HMRC appear to have acknowledged that "the fact that tax consequences have informed the choice of transaction does not always carry with it the implication that obtaining an advantage was a main object".

My conclusion is that the decision should be treated as a reminder that this type of test does indeed set a 'low threshold', as the GAAR guidance describes it. It must always be better to have sought advice and to have taken steps to avoid any disadvantageous tax treatment. However, it is probably also true to say that in many cases a lighter touch from advisers than would previously have been the case may be prudent and that any embellishments that depart from reasonably established practice need to be critically evaluated. HMRC now has a fearsome armoury it can employ if it objects to the tax treatment provided by the black letter provisions of the legislation.

GDF Suez Teeside

Part of this armoury, the Tribunal's occasional willingness to accept creative interpretations of the legislation on behalf of HMRC, is made clear by the week's other case, *GDF Suez Teeside*. Here, the Tribunal dispensed with a good deal of orthodoxy concerning the loan relationships code by finding that the court is able to impose its own assessment of the profit arising from a related transaction, which need not accord with any permissible generally accepted accounting principles (GAAP) accounting treatment (relying instead on 'judgement and common sense'), in place of the actual; and, on the Tribunal's own finding, the only permissible, GAAP accounting treatment adopted by the tax payer. The reasoning, if not the result, will surely be overturned on appeal.

Simply described, the taxpayer company assigned its rights under some 'in-the-money' loan relationships (actually claims in an insolvency – I would be very interested to hear from anyone who can explain why it was common ground that these were loan relationships. Did the Enron administrators issue a loan note?) to a non-UK subsidiary in exchange for shares. This transaction did not give rise to any profit in the company's accounts. While the assignee appears to have been a controlled foreign company (CFC), it appears to have been accepted that the effect of the assignment was to step up its tax basis in the claims for the purposes of the CFC charge to market value, with the result that the in-the-money portion fell out of account altogether. Given that the subsidiary rather than the taxpayer seems to have received all the money, it seems strongly arguable that HMRC is attacking the wrong party.

Even if it stands, the decision will not be directly relevant for new transactions, as it relies on the overriding requirement for the taxable debits and credits to be brought into account to be those which 'fairly represent' profits and losses, which will shortly be repealed. Counsel for HMRC expressed the view that the result would be the same under the rewritten legislation, looking to the new section 455B of the Corporation Tax Act 2009[5] (counteracting loan-related tax advantages).

This seems a reasonable conclusion. The main condition that needs to be fulfilled for that legislation to apply is that one of the main purposes of the relevant arrangements is for a company to obtain a tax advantage under the loan relationship rules[6]. If the tribunal were to approach this in the same way as the test under s.123(4), there doesn't seem to be much doubt that the taxpayer had a least an eye to the tax treatment. Even assuming the comparator analysis has to be considered, I don't think a court would be reluctant to find that it would have been a viable alternative for the taxpayer to hold the claims to maturity rather than assigning them to the subsidiary.

It should, however, be noted that, given the low threshold main purpose tests create, as discussed above, this rule looks likely to create uncertainty in other situations, where it is less clear HMRC is likely to object to the outcome. This is likely to arise in the restructuring context where transactions are often carefully structured in light of the tax treatment among other considerations. HMRC has made a number of helpful changes to the detailed rules which should, generally speaking, increase certainty and reduce the need for clearances. However, at least initially, it may prove difficult for advisers to provide a sufficient level of comfort on this test to make an approach to HMRC unnecessary.

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Endnotes

1. *Lloyds Bank Leasing (No 1) Limited v HMRC Commissioners* [2015] UKFTT 0401 (TC) and *GDF Suez Teeside Limited v HMRC Commissioners* [2015] UKFTT 0413 (TC).
2. Capital Allowances Act 2001.
3. https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/399270/2__HMRC_GAAR_Guidance_Parts_A-C_with_effect_from_30_January_2015_AD_V6.pdf.
4. *CIR v Parker* [1966] AC 141.
5. Currently expected to take effect in relation to arrangements entered into on or after the day on which the Summer Finance Bill gets enacted.
6. There will be a limited exclusion if the relevant tax advantage can reasonably be regarded as consistent with the principles and policy objectives of the loan relationship rules.